

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Joint Petition of Boston Edison Company,)	
Cambridge Electric Light Company,)	
Canal Electric Company and)	D.T.E. 06-40
Commonwealth Electric Company d/b/a)	
NSTAR Electric for Approval of Merger)	

REPLY BRIEF OF RETAIL ENERGY SUPPLY ASSOCIATION

INTRODUCTION

The Retail Energy Supply Association (“RESA”)¹ provides the following comments in response to the September 6, 2006 Initial Briefs filed by Petitioner Boston Edison Company (“Boston Edison”), Cambridge Electric Light Company (“Cambridge”), Canal Electric Company (“Canal”) and Commonwealth Electric Company (“Commonwealth”) d/b/a NSTAR Electric (collectively “NSTAR” and “NSTAR Brief”); and by the Attorney General (“AG” and “AG Brief”); Cape Light Compact (“CLC” and “CLC Brief”); the Energy Consortium (“TEC” and “TEC Brief”); and Massachusetts Institute of Technology (“MIT”) and the President and Fellows of Harvard College (“Harvard”) (collectively, “MIT/Harvard” and “MIT/Harvard Brief”).²

As discussed below, virtually every party other than NSTAR directly opposes the proposal in the May 26, 2006 Joint Petition and the Testimony of Christine Vaughan (“Vaughan Testimony”) to consolidate all Basic Service (also called Default Service) rates for Boston Edison, Cambridge and Commonwealth small commercial and residential customers in both the

¹ RESA members include Consolidated Edison Solutions, Inc., Direct Energy Services, LLC, Hess Corporation, Reliant Energy Solutions, Sempra Energy Solutions, Strategic Energy, LLC, SUEZ Energy Resources NA, Inc. and U.S. Energy Savings Corp. The opinions expressed may not represent the views of all members.

² Limited participant Northeast Energy Associates did not file an Initial Brief; limited participant Direct Energy Services LLC, a member of RESA, relied on the RESA Brief. See RESA Brief at 4 n. 14.

Northeast Massachusetts (“NEMA”) and Southeast Massachusetts (“SEMA”) congestion load zones into a single blended Basic Service rate for each customer class. The Initial Briefs have highlighted that the NSTAR proposal likely would have significant adverse impacts on NSTAR’s customers, competition and the public interest, all contrary to the governing “no net harm” standard for reviewing merger petitions pursuant to G.L. c. 164, § 96. The Department could avoid these harms by ordering NSTAR to establish Basic Service rates for small commercial and residential customers by zone, consistent with how the merged NSTAR (hereinafter “NSTAR Electric”) will procure power if its merger is approved.

RESA also shares CLC’s concerns regarding NSTAR’s proposal to consolidate Default Service Adjustment charges. NSTAR’s use of this mechanism creates an unacceptable risk that customers of competitive suppliers would be double charged for generation costs, harming both the customers and the continued development of retail competition in the Commonwealth.

ARGUMENT

I. THE DEPARTMENT SHOULD REJECT CONSOLIDATION OF DEFAULT SERVICE RATES FOR SMALL COMMERCIAL AND RESIDENTIAL CUSTOMERS AND ORDER ZONE-SPECIFIC PRICING.

The NSTAR Brief reiterates Ms. Vaughan’s testimony that, assuming merger approval, NSTAR Electric will procure power for all customers located within the merged NSTAR service territory.³ It further confirms that there will be separate wholesale power solicitations for each rate class and load zone to comport with the Department’s February 13, 2003 Order in DTE 02-40-A, Investigation by the Department of Telecommunications and Energy on its own Motion into the Provision of Default Service (2003) (the “02-40-A Order”).⁴ NSTAR Electric therefore

³ NSTAR Brief at 12.

⁴ Id. at 12-13.

will make one solicitation for small commercial and residential customers located in the NEMA zone⁵ and a separate solicitation for small commercial and residential customers located in the SEMA zone.⁶ While NSTAR Electric could easily derive different Basic Service rates for these customers located in the NEMA and SEMA load zones, it seeks to average rates across zones, thereby charging them “consolidated” or “blended” rates.”⁷

The NSTAR Brief justifies this proposal on two principal grounds. First, it recites that the “the aggregate level of rates will be no higher than if separate rates (and separate corporate entities) were maintained for Boston Edison, Cambridge and Commonwealth [Consequently] there is no net harm overall from the consolidation.”⁸ Second, the NSTAR Brief maintains that any difference between the blended rates and the separate rates for the NEMA and SEMA load zones is insignificant and will decline in the future.⁹ The first argument finds no support in the law or the facts, and the second is based on a faulty view of the evidence and speculation.

A. NSTAR Has Misconstrued The “No Net Harm” Test.

In applying the “no net harm” standard, the Department does not simply examine whether some specific merger-related rate change or other change will have a neutral “aggregate” impact on the customer population at large, strictly in terms of revenue collected through the rate, and the NSTAR Brief offers no precedent for such a test. The Department instead requires a detailed

⁵ All of the customers presently serviced by Cambridge and approximately 90% of the customers presently serviced by Boston Edison are located in the NEMA load zone.

⁶ All of the customers presently serviced by Commonwealth and the remaining 10% of the customers serviced by Boston Edison are located in the SEMA load zone.

⁷ NSTAR Brief at 13.

⁸ Id. at 12.

⁹ Id. at 13-14.

balancing of the costs and benefits associated with a number of aspects of the merger proposal.¹⁰

The Department considers the factors outlined in Guidelines and Standards for Acquisitions and Mergers, DTE 93-167 (1994) (“Mergers and Acquisitions”),¹¹ including:

- effect on rates;
- resulting net savings;
- effect on competition;
- societal costs; and
- economic development impacts.¹²

A determination under G.L. c. 164, § 96 “must rest on a record that quantifies costs and benefits to the extent that such quantification can be made.”¹³ In relying on its claim that there is no rate impact in the “aggregate” for one aspect of its merger proposal, NSTAR makes no attempt to quantify the costs and benefits of its blended rate proposal and place those costs and benefits in the overall context of its merger petition.

In this instance, it is clear that NSTAR has mischaracterized the benefits and ignored the costs associated with the blended rate proposal, which is, in essence, no more than a proposal to have residential and small commercial customers in one zone subsidize the Basic Service price of residential and small customers in another zone. In that respect, it is better referred to as the “NSTAR Basic Service Subsidy Plan.” In support of its subsidy proposal, NSTAR argues:

The overall consolidation of Basic Service rates will help the Department, the Attorney General and NSTAR Electric minimize the administrative burden of maintaining separate schedules, analyses and filings for what is essentially one operating company (Exh. NSTAR-CLV-1, at 12). In addition, it will be simpler

¹⁰ Massachusetts Electric Company, DTE 99-47 at 18 (2003).

¹¹ Id.

¹² Mergers and Acquisitions, DTE 93-167-A at 7-9.

¹³ Massachusetts Electric Company, DTE 99-47 at 18.

for customers to understand rates and rate changes by providing single unified rates (id.).¹⁴

This argument could have some merit if applied to a shift from three separate procurements to one for the three NSTAR “operating companies,” but it is utterly specious as applied to the NSTAR Subsidy Plan, in which the company proposes to take the straightforward results of its procurement and subject them to tortuous calculation, estimation, and reconciliation. As NSTAR itself admits: “In accordance with Department requirements, supplies for Basic Service are procured on a rate class and load-zone basis (Exh. NSTAR-CLV-1, at 13).”¹⁵ What could be less administratively burdensome than simply pricing Basic Service based on the actual results of the procurement, that is, by rate class and load zone? What could be simpler for customers than knowing that the price they are being charged is the actual cost NSTAR is incurring for procuring the service from its wholesale supplier? In other words, there are absolutely no benefits from this proposal. At the same time, NSTAR ignores the significant negative retail impacts of its proposal.

As discussed in the RESA Brief (at 7-8), the Department determined in the 02-40-A Order that rate blending has potentially adverse impacts on customers and competitors in particular zones that are sufficient to justify implementation of zone-specific pricing for medium-sized and large commercial and industrial (“C&I”) customers and continued study for small commercial and residential customers. If maintaining aggregate rate levels were the only standard, as NSTAR implies, the Department would not have ordered zone-specific pricing in the 02-40-A Order at all. Indeed, if “maintaining aggregate rate levels” were the only standard, most of the Department’s ratemaking precedent could be disposed of, as the only relevant factor

¹⁴ NSTAR Brief at 11-12.

¹⁵ NSTAR Brief at 12.

would be whether a utility collects the full amount of its revenue requirements in some rate or another, without regard to which customers are actually paying those costs.¹⁶ This is not the case, of course. Assigning costs to customers based on cost causation is perhaps the most fundamental precept of Department ratemaking.¹⁷ The NSTAR Subsidy Plan wholly ignores this precept. As a result of the bids the company will receive for Basic Service, one will know with total certainty at what rate each customer, whether residential, small commercial, medium C&I, or large C&I, will cause his or her utility to incur costs. According to Department precedent, that rate must be the rate the customer pays. NSTAR makes no attempt whatsoever to justify a departure from this principle in circumstances where doing the right thing requires almost no effort at all.

B. NSTAR's Assertions That The NEMA-SEMA Price Differential Is Insignificant Is Contradicted By The Evidence And Is Speculative.

The NSTAR Brief implies that a cost-benefit analysis of its rate proposal is not necessary because the difference in wholesale power costs between the NEMA and SEMA load zones is "expected to be minimal and declining in the future."¹⁸ Not only has NSTAR failed to offer persuasive evidence to support that assumption, the evidence contradicts NSTAR's conclusion.

NSTAR contends that, on average, "NEMA's prices were higher than SEMA's prices by only 1.5% and 3.7% for years 2004 and 2005, respectively."¹⁹ NSTAR fails to note the

¹⁶ For example, a plan in which the Basic Service price for all Cambridge Electric customers was set at zero, with customers in the Boston Edison and Commonwealth territories making up the shortfall, would also "maintain aggregate rate levels." Indeed, there is an infinite number of mathematical combinations that would "maintain aggregate rate levels." A "standard" that can be met by an infinite number of proposals is no standard at all.

¹⁷ See Fitchburg Gas and Electric Light Co., DTE 02-24/25, 2002 Mass PUC LEXIS 59, * 354 (2002) ("A fundamental objective of cost allocation is to ensure that cost responsibility is based on cost causation").

¹⁸ NSTAR Brief at 13-14.

¹⁹ NSTAR Brief at 14.

substantial differences in individual months between the NEMA and SEMA locational marginal prices (“LMPs”) during 2005 (as high as 12.1% in August 2005)²⁰ and even larger deviations during months in the first half of 2006 (as high as 18.2% in May 2006).²¹ The record demonstrates that zonal pricing differences are substantial and actually increasing over time. Moreover, as CLC observes, NSTAR actually understates the differences between NEMA and SEMA LMPs because it used real-time market prices rather than prices in the forward market where Basic Service is procured and where zonal price differentials are even more pronounced.²²

Similarly, the record evidence contradicts NSTAR’s assertion that the NEMA-SEMA price gap will be further closed by changes in Reliability Must Run (“RMR”) contracts and Special Constraint Resources costs.²³ The increasing price differentials between NEMA and SEMA have been affected by new congestion charges in one or both zones, which NSTAR acknowledges it cannot predict on a going forward basis with any accuracy. As noted by CLC:

NSTAR’s reluctance to make any predictions regarding congestion costs has its counterpart in NSTAR’s reluctance to make any predictions regarding uplift costs that are imposed in ISO New England on load serving entities and that are included in default service rates through an adder. *See, e.g.,* Tr. 259 (NSTAR witness testifies that she cannot even make an “educated guess” regarding 2007 RMR costs). Again, without providing some forecast of uplift costs “substantiated by past experience, and supported by logical reasoning founded on sound theory,” *Massachusetts Electric Company*, D.T.E. 99-47, NSTAR has failed to provide a meaningful analysis of the financial impacts of consolidating default service rates.²⁴

²⁰ Exh. NSTAR-CLV-4, at 14.

²¹ NSTAR Response to Information Request RESA-1-2.

²² CLC Brief at 12-13.

²³ See NSTAR Response to Information Request RESA-1-3, at 1.

²⁴ CLC Brief at 14.

In addition to understating the growing price differentials, NSTAR also claims that the new 345 kV transmission upgrade will minimize future differences in wholesale zonal prices.²⁵ NSTAR has not performed any studies to quantify the impact of the transmission upgrade on the NEMA-SEMA price differential as it is required to do under the law.²⁶ Indeed, the AG recommended that NSTAR's blended rate proposal be rejected on that ground alone until the line enters service and effects of the new line are identified and quantified.²⁷

Finally, NSTAR's focus on the level of subsidy that would be caused by its proposal misses the critical point, which is that subsidies are bad policy, and having NSTAR go out of its way to create a subsidy for two additional distribution companies where one would not otherwise exist is indefensible. The fact that the subsidy might be 1.5% or 3.7% or something greater or lesser is beside the point. Any subsidy violates the great majority of Department precedent and, in this instance, falls well outside the narrow justifications the Department relied upon in the 02-40-A Order.²⁸

C. Blending Basic Service Rates Will Harm The Public Interest.

The parties have identified three ways in which NSTAR's rate blending proposal would harm the public interest. First, SEMA customers will be overcharged for Basic Service, while NEMA customers will be undercharged.²⁹ Second, by artificially depressing the Basic Service

²⁵ NSTAR Brief at 14.

²⁶ RESA Brief at 12-13; CLC Brief at 13.

²⁷ AG Brief at 14-16.

²⁸ NSTAR's dismissive attitude toward certain percentages ("On an average, 12-monthly-load-weighted basis, NEMA's prices were higher than the SEMA's prices by only 1.5 percent and 3.7 percent, for the years 2004 and 2005, respectively") is also specious. "Only" a couple of percentage points still represent a transfer of millions of dollars of wealth from customers in one zone to customers in the other. In other contexts, such as perhaps a proposed reduction of a couple of percentage points in the return on equity in a rate case, such percentages would likely matter a great deal to NSTAR.

²⁹ RESA Brief at 10; CLC Brief at 14.

price in the NEMA load zone, NEMA customers will have less of an incentive to engage in energy conservation measures in the region where they are most urgently needed.³⁰ Third, the blending of Basic Service rates across load zones will skew the market and hinder the development of retail competition for the small commercial and residential customer classes.³¹

1. The Department Has Previously Recognized The Potential Adverse Impacts Of Blended Rates On Customers And Competitors In The Commonwealth.

In the 02-40-A Order, the Department recognized that blending Basic Service rates across load zones can have an adverse impact on both competitive suppliers and customers.³² As both RESA and TEC explain in their Briefs, NSTAR entirely ignores these concerns. Instead, NSTAR claims that the 02-40-A Order supports the expansion of blended Basic Service rates to all small commercial and residential customers in the merged NSTAR Electric service territory.³³ NSTAR's conclusion is based on a misreading of the 02-40-A Order.

The 02-40-A Order was issued just prior to ISO New England Inc.'s implementation of its LMP zonal pricing system.³⁴ At that time, only two distribution companies – Boston Edison and Massachusetts Electric Company (“MECo”) – served customers located across different load zones in Massachusetts. The purpose of the 02-40-A proceeding was to address the question whether these two distribution companies should be required to procure power and set Default

³⁰ RESA Brief at 10.

³¹ Id.; TEC Brief at 16-18; MIT/Harvard Brief at 16.

³² 02-40-A Order at 8-9.

³³ NSTAR Brief at 13 (noting that small commercial and residential customers throughout the merged NSTAR Electric territory will receive blended rates in accordance with Department policies established in the 02-40-A proceeding).

³⁴ 02-40-A Order at 3.

Service prices by zone.³⁵ Although the Department ordered Boston Edison and MECo to establish zone-specific prices for medium-sized and large C&I customers, in recognition of the adverse impacts on customers and competitors, it allowed them to maintain territory-wide Default Service rates for small commercial and residential customers.³⁶ In so ruling, the Department explained that “[t]he introduction of zone-differentiated rates for residential and small C&I customers has potential for customer confusion, especially given the uncertainty as to what the magnitude of zonal price differences will be.”³⁷ The Department stated, however, that it intended to revisit this issue after it gained experience with the LMP zonal pricing model.³⁸ The Department also expressed its commitment to take “reasonable actions that remove barriers to competition for all customer classes”³⁹

The Department’s 02-40-A Order simply does not mandate the expansion of Basic Service rate blending that NSTAR proposes in this proceeding. TEC properly observes that the Order was not issued within the context of a merger of multiple franchise areas, but, rather, it addressed only single franchise areas with customers in different zones.⁴⁰ Hence, it does not dictate rate blending practices that expand the minimal amount occurring within Boston Edison (less than 10%) to the existing Commonwealth and Cambridge service territories.⁴¹ Moreover, the Order reflects that the Department intended only an interim solution for the small commercial

³⁵ Id. at 4.

³⁶ Id. at 9-11.

³⁷ Id. at 11.

³⁸ Id.

³⁹ Id. at 10.

⁴⁰ TEC Brief at 17.

⁴¹ Id.

and residential customer classes that crossed zones at that time, as evidenced by its statement that it would revisit this practice in the future.

As RESA noted in its Brief, this proceeding presents the perfect opportunity to revisit the practice of blending Basic Service rates for customers presently served by Boston Edison. After the merger, NSTAR Electric will not solicit separate power supply bids for customers located in the existing Boston Edison territory and will instead, conduct Company-wide procurements by rate class and load zone. Thus, it is both impractical and unnecessary to maintain the rate blending policy for customers presently served by Boston Edison. Second, the Department now has over three years' experience with LMP pricing, and the statistics show that the differences between LMPs in the NEMA and SEMA load zones are sufficiently pronounced to warrant zone-specific pricing for all small commercial and residential customers.⁴² Third, directing NSTAR to adopt zone-specific pricing will keep retail choice viable for these customer classes. Finally, rejecting the NSTAR Subsidy Plan would be true to the Department's fundamental principle that cost recovery in rates should be based on cost causation.

D. NSTAR Has Not Substantiated Its Billing Concerns.

An apparent impetus for NSTAR's blended rate proposal is its unwillingness to further modify its billing systems to implement separate zonal prices.⁴³ NSTAR makes no attempt to quantify likely billing system modification costs or compare them to the potential harms flowing from its blended rate proposal, as discussed in Section I.C above. NSTAR simply states that "[t]he time required to implement the modifications and the costs of such modifications would

⁴² RESA also urges the Department to open a separate docket to examine whether the blending of rates in the MECo service territory should be abandoned in favor of zone-specific pricing.

⁴³ See NSTAR Response to Information Request RESA-1-3, p. 1 ("[T]he Companies note that implementing separate zonal prices for residential and commercial customers would require significant modifications to the Companies' billing and customer-accounting systems").

outweigh any benefits to customers from the zonal pricing.”⁴⁴ This conclusory assertion is not sufficient to justify NSTAR’s blended rate proposal under the “no net harm” test. Moreover, NSTAR advanced this same billing system modification cost argument in the 02-40-A proceeding.⁴⁵ The Department nevertheless ordered Boston Electric to proceed with the adoption of zonal pricing for medium-sized and large C&I customers in the Boston Edison territory for these classes.⁴⁶ The Department should follow the same course in this proceeding. Moreover, NSTAR’s argument regarding the time and cost involved in modifying its billing system to accommodate this change – (an argument NSTAR often raises when approached with a proposal intended to support competition) – assumes that its customers rather than its shareholders would pay those costs. If it is NSTAR’s position that its billing system is so inflexible that it cannot render bills for residential and small commercial customers on a zonal basis, thus requiring one group to subsidize another, then it has clearly acted imprudently in designing and building its billing system, and NSTAR shareholders rather than its customers should pay to fix it.

II. RESA SHARES CLC’S CONCERNS THAT THE CONSOLIDATED DEFAULT SERVICE ADJUSTMENT CHARGES COULD HARM COMPETITIVE SUPPLIERS AND THEIR CUSTOMERS.

The Department has allowed distribution companies to collect from Basic Service customers their costs that were not fully recovered in rates.⁴⁷ NSTAR now seeks to recover this adjustment (commonly known as the “Default Service Adjustment Mechanism”) from all of its distribution customers and not just those customers that take Basic Service in lieu of a

⁴⁴ Id.

⁴⁵ 02-40-A Order at 7, 10 n. 9.

⁴⁶ Id. at 9-10.

⁴⁷ See CLC Brief at 11.

competitive offering.⁴⁸ As CLC properly notes, the harm to customers and competitors from this practice will be exacerbated by NSTAR's consolidated rate proposal.⁴⁹

CLC has previously argued that the Default Service Adjustment Mechanism causes customers that purchase electricity from a competitive supplier to pay for generation service twice – once in the price of its retail offering and again through distribution charges. The CLC Brief notes that NSTAR's blended rate proposal will enlarge this problem because customers on competitive supply may find themselves paying for a portion of the unrecovered costs of providing Basic Service to customers located throughout the merged NSTAR territory (as opposed to just the service territory where the competitive supply customers are located).⁵⁰ RESA shares this concern and urges appropriate modifications to the Default Service Adjustment Mechanism as a merger condition that would avoid this unfair result.

⁴⁸ Id.

⁴⁹ Id.

⁵⁰ Id.

CONCLUSION

RESA respectfully requests that the Department reject the NSTAR petition to consolidate all rates for small commercial and residential customers across the NEMA and SEMA load zones, as contrary to principles articulated in the Department's February 2003 order in Docket No. 02-40-A and the governing "no net harm" standard. Instead, the Department should direct NSTAR to adopt full zone-specific pricing as a condition of the merger. It also should direct NSTAR to modify its Default Service Adjustment Mechanism to avoid the payment of duplicate generation charges by customers who opt for retail product offerings.

RETAIL ENERGY SUPPLY
ASSOCIATION



Robert J. Munnelly, Jr.
Diana M. Kleefeld
Murtha Cullina LLP
99 High Street – 20th Floor
Boston, MA 02110
Telephone: (617) 457-4062
Fax: (617) 482-3868

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